

Message Text

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ACTION EB-03

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FM AMCONSUL HONG KONG

TO SECSTATE WASHDC 5543

INFO USLO PEKING

AMEMBASSY LONDON

AMEMBASSY SEOUL

AMEMBASSY SINGAPORE

AMEMBASSY TAIPEI

AMEMBASSY TOKYO

C O N F I D E N T I A L HONG KONG 6977

LIMDIS

PASS TREASURY AND FEDERAL RESERVE BANK

E.O. 11652: GDS

TAGS: EFIN, HK

SUBJECT: EXCHANGE RATE POLICY AND GOVERNMENT BORROWING

REF: HK 4173

1. SUMMARY: THE GOVERNMENT HAS BEEN PURSUING A POLICY OF SLOWLY BUT STEADILY DEPRECIATING THE HONG KONG DOLLAR TOWARD THE PARITY IT ABANDONED LAST NOVEMBER WHEN FACED WITH AN INFLUX OF FUNDS. TO AVOID AFFECTING THE EXCHANGE RATE IT HAS ALSO CHOSEN TO FINANCE MOST OF ITS BUDGET DOMESTICALLY. LOCAL INVESTORS REMAIN WARY OF THE U.S. DOLLAR AND PREFER TO STAY IN THEIR OWN CURRENCY. (END SUMMARY)

2. THE HONG KONG DOLLAR EXCHANGE RATE HAS NOW MOVED TO THE LOWER SUPPORT POINT (4.96/1) OF ITS OLD PARITY, ABANDONED LAST NOVEMBER WHEN HKG PANICKED IN THE FACE OF A LARGE INFLOW OF FUNDS. THREE FACTORS HAVE BEEN AT WORK:

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A) DIRECT INTERVENTION,

B) THE STRENGTHENING OF THE U.S. DOLLAR AGAINST THE
MAJOR EUROPEAN CURRENCIES, AND

C) THE END OF AN INFLOW OF FUNDS THAT IN RECENT
MONTHS PROBABLY ORIGINATED IN SOUTH VIETNAM.

3. AS PREVIOUSLY REPORTED, INTERVENTION BEGAN AT THE
END OF FEBRUARY. CONFIDENTIAL ARRANGEMENTS TO BORROW WERE TO
PROVIDE SUFFICIENT HONG KONG DOLLAR RESOURCES HAVE BEEN CONCLUDED.
THE STRENGTHENING OF THE U.S. DOLLAR ELSEWHERE,
FROM MARCH ON, HELPED A GOOD DEAL.
BUT THE MALAISE IN VIETNAM APPARENTLY CAUSED AN INFLOW OF FUNDS
IN MARCH AND APRIL. THE COLONY'S PRINCIPAL FOREIGN EXCHANGE TRADER
STATED PRIVATELY, HOWEVER, THAT THIS MOVEMENT CEASED AT THE END OF
APRIL, I.E., WITH THE FALL OF SAIGON.

4. ON JUNE 18, THE FINANCIAL SECRETARY PROVIDED, PUBLICALLY,
SOME DETAIL ON THE GOVERNMENT'S PROPOSED BORROWING. THE LARGER
PART OF THE PROJECTED HK\$430 MILLION WOULD BE COVERED BY A
HK\$250 MILLION ISSUE OF FIVE YEAR FUNDS. THIS IS HONG KONG'S
FIRST POSTWAR DOMESTIC BORROWING. ALTHOUGH NOT STATED, THE REASON
FOR TAPPING THE DOMESTIC RATHER THAN THE MARKETS ABROAD, IS TO
AVOID THE STRENGTHENING OF THE HONG KONG DOLLAR THAT WOULD RESULT
FROM THE CONVERSION OF THE PROCEEDS OF A FOREIGN CREDIT.

5. ONE HK\$75 MILLION FOREIGN CREDIT IS BEING NEGOTIATED BUT
IT IS FOR FOREIGN PURCHASES. WHERE THE REMAINDER OF THE PROJECTED
FINANCING WILL TAKE PLACE WILL DEPEND ON THE STATE OF DOMESTIC
LIQUIDITY AND WHAT IS EXPECTED TO HAPPEN TO THE HONG KONG DOLLAR
IN THE REST OF THE FISCAL YEAR (ENDING MARCH 31, 1976).

6. THE ELEMENTS INFLUENCING THE EXCHANGE RATE IN THE COMING
MONTHS ARE THE GOVERNMENT'S INTERVENTION POLICY, AND THE WAY THE
BEHAVIOR OF THE U.S. DOLLAR IN MAJOR CURRENCY MARKETS EFFECTS
LOCAL PRIVATE INVESTOR ATTITUDES. FOR THE MOVEMENT, THE GOVERN-
MENT SEEMS RESTING ON ITS OARS, SATISFIED WITH THE PRESENT
SITUATION AND MODERATELY CONFIDENT THAT EXPORTS WILL PICK UP
SOON. BA IT IS POSSIBLE THAT IF THE WORLD EXPORT REVIVAL
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OCCURS AND HONG KONG IS NOT BENEFITING VERY MUCH, THE RATE MIGHT
BE EDGED UP TO THE OLD INTERVENTION POINT 5.20/1, A DEPRECIATION
OF 5 PERCENT FROM PRESENT LEVELS.

7. PROBABLY MOST IMPORTANT IS THE ATTITUDE OF LOCAL INVESTORS
WHO HAVE BEEN DIVIDING THEIR LIQUID ASSETS BETWEEN THE
HONG KONG AND U.S. DOLLAR. AFTER WATCHING THE U.S. DOLLAR MOVE
UP AND DOWN AGAINST THE DEUTSCHEMARK AND SWISS FRANC, AND, GIVEN

THE POSSIBILITY THAT THE HONG KONG DOLLAR COULD APPRECIATE AGAIN
AGAINST THE U.S. CURRENCY, THE TENDENCY IS TO PLAY SAFE AND
REMAIN IN THEIR OWN MONEY. THIS HAS OCCURRED IN SPITE OF
HIGH LIQUIDITY AND AT LEAST A 3 PERCENT INTEREST DIFFERENTIAL IN
FAVOR OF EURODOLLARS. ONLY A PROLONGED APPRECIATION OF THE U.S.
DOLLAR ELSEWHERE IS LIKELY TO SHAKE THIS ATTITUDE.
CROSS

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